REPORT OF EXAMINATION
OF THE

CALIFORNIA CASUALTY
INDEMNITY EXCHANGE

AS OF
DECEMBER 31, 2006

Participating State
and Zone:

California

Filed June 13, 2008

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San Francisco, California
April 25, 2008

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Insurance Division
Santa Fe, New Mexico

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA CASUALTY INDEMNITY EXCHANGE

(hereinafter also referred to as the Exchange) at its home office located at 1900 Alameda de las Pulgas, San Mateo, California 94403.

SCOPE OF EXAMINATION

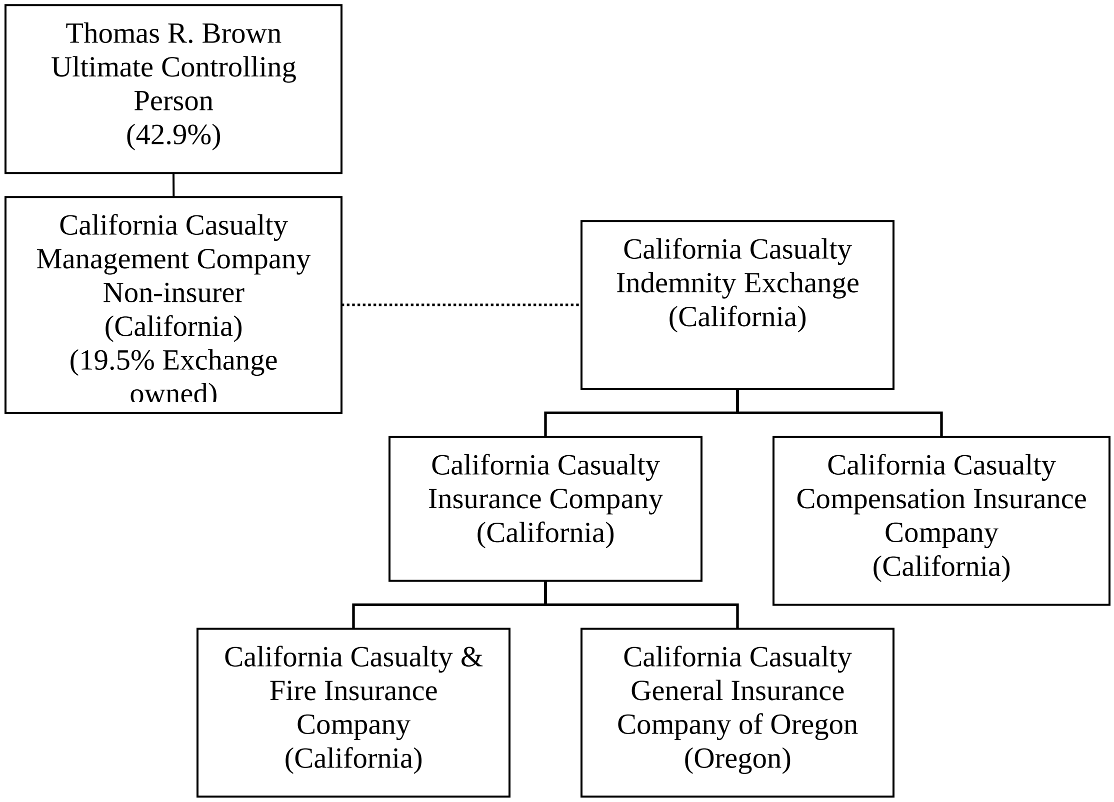
The previous examination of the Exchange was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2006. The examination included a review of the Exchange's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination was conducted concurrently with the Exchange's four subsidiaries, California Casualty Insurance Company, California Casualty General Insurance Company of Oregon, California Casualty & Fire Insurance Company, and California Casualty Compensation Insurance Company. These insurers are collectively referred to as the California Casualty Group (Group) hereinafter.

In addition to those items specifically commented upon in this report, other phases of the Exchange's operations were reviewed including the following areas that require no further comment: exchange history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; loss experience; and sales and advertising.

MANAGEMENT AND CONTROL

The Exchange is a member of an insurance holding company system of which the California Casualty Management Company (CCMC) controls the Exchange as the attorney-in-fact. As of December 31, 2006, Thomas Runnels Brown owned or controlled 42.9% of the Class A voting common stock of CCMC. The following is an abridged organizational chart showing the relationship of the Exchange in the holding company system:



(*) all ownership is 100% unless otherwise noted.

As of December 31, 2006, CCMC held a 49% ownership interest in Pillar Point Equity Management, LLP (PPEM). PPEM provides investment management services to CCMC and the Group as described below under the section "Intercompany Agreements." On September 26, 2007, PPEM purchased CCMC's ownership interest in PPEM and ceased being a member of the California Casualty holding company group. This transaction resulted in no change to the investment management agreement.

The operations and affairs of the Exchange are subject to the supervision and control of a seventeen-member Advisory Board in conformance with the Underwriters Agreement. A listing of the members of the Advisory Board serving on December 31, 2006 follows:

Members of the Advisory Board

Name and Residence	Principal Business Affiliation
David Allen Aaker Orinda, California	Retired University of California, Berkeley
James David Altman Menlo Park, California	Retired Johnson & Higgins of California
Carl Beaumont Brown* Palo Alto, California	President and Chief Executive Officer California Casualty Management Company
Jonathan Archer Brown Fair Oaks, California	President Association of Independent Colleges and Universities
Thomas Runnels Brown* Atherton, California	Chairman of the Board California Casualty Management Company
John Edward Cahill, Jr. Kentfield, California	Chairman and Chief Executive Officer Chahill Contractors, Inc.
William Rynol Dahlman North Hollywood, California	President and Chief Executive Officer Employers Group
Wayne Shawn Diviney Norfolk, Virginia	Retired National Education Association
Carolyn Ellen Doggett Belmont, California	Executive Director California Teachers Association
Jon Howell Hamm El Dorado Hills, California	Executive Manager California Association of Highway Patrolmen
Richard Wayne Johnson Santa Barbara, California	Retired California Teachers Association
R. Kirk Lindsey Modesto, California	President Brite Transport System, Inc.
George Goodrich Coale Parker Portola Valley, California	Professor of Finance Stanford University, Graduate School of Business

Members of the Advisory Board (continued)

Name and Residence	Principal Business Affiliation
Edward Garland Phoebus III Silver Spring, Maryland	Vice President National Education Association Member Benefits
Lynne Francine Siegel Portland, Oregon	Retired Oregon Education Association
Ralph Matthew Tornatore, Jr. Cool, California	Retired California Association of Highway Patrolmen
Suzanne Marie Zimmer Golden, Colorado	Assistant Executive Director Colorado Education Association

**Per the Bylaws of the Advisory Board, Thomas Runnels Brown and Carl Beaumont Brown cannot vote on matters that come before the Advisory Board while serving as officers of CCMC.*

Officers of the Advisory Board

Name	Title
Thomas Runnels Brown	Chairman of the Advisory Board
George Goodrich Coale Parker	Vice Chairman
David Allen Aaker	Secretary

Attorney-In-Fact

Pursuant to the Underwriters Agreement made by the subscribers of the Exchange, CCMC is appointed as attorney-in-fact of the Exchange. The principal officers of the attorney-in-fact at December 31, 2006, were as follows:

Name	Title
Kai Grant Edwin Anderson**	President and Chief Executive Officer
Michael Allen Ray	Chief Financial Officer and Treasurer
James Michael Sevey	Secretary

***Kai Grant Edwin Anderson retired on February 28, 2007 and was replaced by Carl Beaumont Brown.*

Intercompany Agreements

The Exchange is managed by California Casualty Management Company (CCMC) under an Underwriters Agreement. Under this agreement, CCMC is paid a monthly fee of up to 125% of expenses incurred by CCMC on behalf of the Exchange. An annual incentive fee of up to 10% of the California Casualty Group's calendar year pre-tax income, calculated after giving effect to such incentive, may also be paid to CCMC. During 2006, the Exchange paid CCMC $114.4 million for the services provided under this agreement. The agreement (version dated October 6, 1993) was reviewed and approved by the California Department of Insurance (CDI) on November 12, 1993.

Effective January 1, 1999, the Exchange entered into an amended tax allocation agreement with the other insurers in the California Casualty Group. Under this agreement, the consolidated federal income tax liability of the Group is allocated to each company in proportion to each company's share of taxable income, computed on a separate company basis. The Exchange is responsible for filing and making all tax payments on behalf of the Group. The tax allocation agreement was submitted to the CDI pursuant to California Insurance Code (CIC) Section 1215.5(b)(4) on March 26, 2008 and is currently under review.

Effective October 1, 2004, CCMC, as attorney-in-fact for the Exchange, entered into an Investment Management Agreement with Pillar Point Equity Management, LLC (PPEM). Under this agreement, PPEM manages CCMC's and the Group's investments in accordance with the California Casualty Group Investment Policy Statement. PPEM is paid an annual fee equal to 0.5% of the market value of the securities under management, billed monthly in arrears. During 2006, the Exchange paid $200,000 to PPEM for the services provided under this agreement.

Pursuant to CIC Section 1215.5(b)(4), the Investment Management Agreement was submitted to the CDI and approved on October 25, 2004.

TERRITORY AND PLAN OF OPERATION

The Exchange became licensed in Mississippi in 2004 and Alaska in 2007, making it licensed to transact business in all states except Michigan and New Jersey. The Exchange is also licensed in the District of Columbia.

Direct written premiums in 2006 were $270 million. California accounted for 56% of the total direct written premium. Direct written premiums in Oregon were 6.3%, in Colorado 6.2%, in Nevada 3.6% and in New Mexico 3.1%. In 2006, the principal direct lines of business written were auto liability, auto physical damage and homeowners multiple peril, accounting for 43%, 36%, and 20% of total direct written premiums, respectively.

The Exchange has no employees. California Casualty Management Company (CCMC), the attorney-in-fact for the Exchange, has approximately 700 employees, many of whom perform services for the Exchange in accordance with the Underwriters Agreement. CCMC conducts operations from its home office in San Mateo, California and three service centers, providing comprehensive claims, underwriting, marketing, sales and administrative services. CCMC provides production and operating facilities pursuant to the provisions of the Underwriters Agreement. Under the terms of a separate management agreement with CCMC, the other companies in the Group share with the Exchange management, facilities, sales, and underwriting and loss adjustment personnel.

The Group is a highly specialized personal lines insurer that provides private passenger automobile and homeowners insurance to members of affinity groups primarily involved in education, law enforcement and public safety. Personal lines business is produced directly through licensed insurance agents, who are employees of CCMC. The agents receive a salary only (no commissions are paid), and are entitled to a bonus if the number of policies sold exceeds a given threshold.

REINSURANCE

Pooling Agreement

A revised pooling agreement was approved by the California Department of Insurance and Oregon Division of Insurance effective January 1, 2006. Under the terms of the agreement, the companies cede 100% of their direct business to the Exchange. The agreement also includes a provision whereby personal lines insurance business is retroceded to, and assumed by, California Casualty Insurance Company (CCIC), California Casualty & Fire Insurance Company (CCFIC), and California Casualty General Insurance Company of Oregon (CCGIC) according to their respective pooling percentages of 8%, 10%, and 12%. The Exchange retains 70% of the pooled personal lines business. All workers' compensation and miscellaneous commercial lines direct and assumed business are in run-off and are retroceded 100% to California Casualty Compensation Insurance Company (CCCIC).

Assumed

The Exchange is the only insurer in the pool that assumes business from non-affiliates. As of December 31, 2006, assumed premiums were under a facultative certificate covering a single policy, and were not material. The Exchange also has immaterial assumed reserves in run-off from Lumbermen's Mutual Casualty Company.

Ceded

Effective January 1, 2000, CCIC, CCFIC, CCGIC, and the Exchange (the Group) entered into a 15-year quota-share reinsurance agreement with Fireman's Fund Insurance Company (FFIC) on the Group's personal lines of business. Under the terms of this agreement, for the first five years of the treaty, the Group cedes 20% of personal lines written premiums and losses, and earns a ceding commission equal to 20% of the underwriting expenses. For the subsequent ten years of the treaty, the Group cedes 30% of the written premiums and losses and earns a ceding commission equal to 30% of underwriting expenses.

The Exchange had the following additional reinsurance agreements in effect at December 31, 2006:

Type of Contract	Line of Business	Reinsurer's Name	Exchange's Retention	Reinsurer's Limits
Catastrophe Excess of Loss				
1st Layer Excess of Loss	Property	Authorized Underwriter's at Lloyd's, London – 25% General Reinsurance Company – 15% American Re-insurance – 10% Unauthorized XL Re, Ltd. – 10% Mapfre Re – 5%	$15 million plus 35% of $10 million excess of $15 million per occurrence	65% of $10 million per occurrence excess of $15 million, $20 million annual aggregate
2nd Layer Excess of Loss	Property	Authorized Underwriter's at Lloyd's, London – 24% General Reinsurance Company – 12% American Re-insurance – 10% Transatlantic Re – 10% Unauthorized XL Re, Ltd. – 9% Mapfre Re – 5%	$25 million plus 30% of $20 million excess of $25 million per occurrence	70% of $20 million per occurrence excess of $25 million, $40 million annual aggregate
3rd Layer Excess of Loss	Property	Authorized Underwriter's at Lloyd's, London – 29.5% American Re-insurance – 15% Transatlantic Re – 10% American Agriculture Insurance Company – 3% Unauthorized Mapfre Re – 10% XL Re, Ltd. – 7.5% Hannover Re – 5%	$45 million plus 20% of $35 million excess of $45 million per occurrence	80% of $35 million per occurrence excess of $45 million, $70 million annual aggregate

The Group discontinued writing workers' compensation business in 1997, except for domestic workers' compensation coverage under homeowner's policies. Under the pooling agreement, all workers' compensation and miscellaneous commercial business in force are retroceded to CCCIC. Effective January 1, 2001, CCCIC entered into an adverse loss development cover with XL Re, Ltd., of Hamilton, Bermuda, covering workers' compensation claims with dates of injury prior to January 1, 1999.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the year ended December 31, 2006

Reconciliation of Surplus as Regards Policyholders from December 31, 2003
through December 31, 2006

Statement of Financial Condition
as of December 31, 2006

Assets	Ledger and Non-ledger Assets	Non-Admitted Assets	Net Admitted Assets	Notes
Bonds	$ 163,401,269	$	$ 163,401,269	
Common stocks	204,194,487		204,194,487	
Cash and short-term investments	5,269,662		5,269,662	
Receivable for securities	425		425	
Investment income due & accrued	1,686,581		1,686,581	
Premiums and agents' balances in course of collection	56,951,908	129,380	56,822,528	(1)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	81,499,718		81,499,718	(1)
Reinsurance recoverables	16,071,772		16,071,772	(2)
Current federal income tax recoverable	692,005		692,005	
Net deferred tax asset	4,898,785		4,898,785	
Guaranty funds receivable	7,668		7,668	
Furniture and equipment	34,400	34,400		
Aggregate write-ins for other than invested assets	365,040	365,040		
Total assets	$ 535,073,720	$ 528,820	$ 534,544,900	

Liabilities, Surplus and Other Funds			Notes
Losses		$ 62,810,624	(3)
Reinsurance payable on paid losses and loss adjustment expenses		333,271	
Loss adjustment expenses		17,013,873	(3)
Commissions payable, contingent commissions and other similar charges		1,837,334	
Other expenses		553,200	
Taxes, licenses and fees		449,668	
Unearned premiums		85,174,580	
Advance premiums		222,181	(1)
Ceded reinsurance premiums payable		54,895,055	
Amounts withheld or retained by company for account of others		2,442,588	
Payable to parent, subsidiaries and affiliates		2,858,668	(4)
Aggregate write-ins for liabilities		225,651	
Total liabilities		228,816,693	
Unassigned funds	$ 305,728,207		
Surplus as regards policyholders		305,728,207	
Total liabilities, surplus and other funds		$ 534,544,900	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2006

Statement of Income

Underwriting Income		
Premiums earned		$ 171,231,493
Deductions:		
Losses incurred	$ 92,701,725	
Loss expenses incurred	30,427,517	
Other underwriting expenses incurred	51,306,053	
Total underwriting deductions		174,435,295
Net underwriting loss		(3,203,802)
Investment Income		
Net investment income earned	$ 11,627,433	
Net realized capital gains	2,035,056	
Net investment gain		13,662,489
Other Income		
Net loss from agents' balances or premium balances charged off	$ (555,480)	
Finance and service charges not included in premiums	1,362,025	
Total other income		806,545
Net income before federal income taxes		11,265,232
Federal income taxes incurred		1,982,655
Net income		$ 9,282,577

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2005		$ 289,894,993
Net income	$ 9,282,577	
Change in net unrealized capital gains or losses	5,182,447	
Change in deferred income tax	1,335,161	
Change in nonadmitted assets	33,029	
Change in surplus as regards policyholders for the year		15,833,214
Surplus as regards policyholders, December 31, 2006		$ 305,728,207

Reconciliation of Surplus as Regards Policyholders
from December 31, 2003 through December 31, 2006

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2003, per Examination			$ 266,065,705
Net income	$ 43,132,675	$	
Change in net unrealized capital losses		1,973,733	
Change in net deferred income tax		6,274,642	
Change in nonadmitted assets	4,778,202		
Totals	$ 47,910,877	$ 8,248,375	
Net increase in surplus as regards policyholders			39,662,502
Surplus as regards policyholders, December 31, 2006, per Examination			$ 305,728,207

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Premiums and Agents' Balances, Deferred Premiums, and Advance Premiums

The Exchange was not in compliance with Statements of Statutory Accounting Principles (SSAP) No. 53, paragraph 13, because advance premiums were incorrectly reported as an offset to the premiums and agents' balances in course of collection and deferred premiums, agents' balances and installments booked but deferred and not yet due accounts. SSAP No. 53, paragraph 13, requires that advance premiums be reported as a liability in the statutory financial statement. No examination adjustment was made since the amount involved is immaterial. It is recommended that the Exchange comply with SSAP No. 53, paragraph 13.

(2) Reinsurance Recoverables

The amount of letters of credit reported in Schedule F Part 5 is more than the amount actually held by the Exchange as of December 31, 2006. No exam adjustment was made because the letters of credit actually held are more than the reinsurance credits taken on behalf of the unauthorized reinsurers. It is recommended that the Exchange ensure that the letters of credit reported in Schedule F Part 5 accurately reflect such amounts actually held so that this schedule will not be misleading.

(3) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Exchange's loss and loss adjustment expense reserves as of December 31, 2006 were found to be reasonably stated and have been accepted for purposes of this examination.

The Exchange was not in compliance with California Insurance Code (CIC) Section 11558 because its carried liability reserves at December 31, 2006 for the most recent three accident years were below the statutory minimum reserves required by CIC Section 11558. The deficiency was immaterial and no examination adjustment was made. It is recommended that the Company comply with CIC Section 11558.

(4) Payable to Parent, Subsidiaries and Affiliates

The intercompany pooling agreement requires settlements to be made within 90 days after each month end. During the review of the intercompany accounts, it was noted that not all settlements were made within the 90 day period. Management stated that if a pool member does not have the investment funds available to settle completely, the receivable or payable is carried until the funds are available. The Group tries to avoid selling securities to settle intercompany balances. It is recommended that the Group try to settle intercompany balances within the timeframe described in the intercompany pooling agreement.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Comments on Financial Statement Items - Premiums and Agents' Balances, Deferred Premiums, and Advance Premiums (Page 14): It is recommended that the Exchange comply with SSAP No. 53, paragraph 13.

Comments on Financial Statement Items – Reinsurance Recoverables (Page 14): It is recommended that the Exchange ensure that letters of credit reported in Schedule F Part 5 accurately reflect such amounts actually held so that this schedule will not be misleading.

Comments on Financial Statement Items – Losses and Loss Adjustment Expenses (Page 14): It is recommended that the Exchange comply with California Insurance Code (CIC) Section 11558.

Comment on Financial Statement Items – Payable to Parent, Subsidiaries and Affiliates (Page 15): It is recommended that the Group try to settle intercompany balances within the timeframe described in the intercompany pooling agreement.

Prior Report of Examination

Reinsurance - Ceded (Page 9): It was recommended that the Exchange complete its negotiations with Fireman's Fund Insurance Company so that the quota-share reinsurance agreement between the companies complies with CIC Section 922.2(a) (2) and SSAP No. 62, paragraph 7. The Exchange is now in compliance with the above section and SSAP.

Accounts and Records - Information System Controls (Page 12): It was recommended that the Exchange evaluate the recommendations made and make appropriate changes to strengthen controls over its information system. The recommendations from the previous examination have been implemented.

Receivable from Parent, Subsidiaries and Affiliates (Page 17): It was recommended that the Exchange report pooled accounts and intercompany balances in accordance with Annual Statement instructions and settle them on a regular basis. Pooled accounts and intercompany balances are reported in accordance with the Annual Statement Instructions; however, not all intercompany balances are settled on a regular basis.

ACKNOWLEDGMENT

The courtesy and cooperation extended by the Exchange's officers and California Casualty Management Company's employees during the course of this examination is hereby acknowledged.

Respectfully submitted,

__________/S/________________

Ber Vang, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California